Committee of European Banking Supervisors – CEBS
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# EAPB comments on CEBS's draft implementation guidelines on the revised large exposure regime

We would like to thank CEBS for the opportunity to comment on the draft implementation guidelines. We also appreciated the public hearing CEBS organised on this issue. The timing towards the end of the consultation period contributed to the lively discussion and was very much welcome.

At the outset, we would like to draw your attention to the fact that the requirements outlined in the draft paper necessitate considerable adaptation in the Member States as to the applications relating to the IT, credit decisions and reporting. A number of institutions will see a significant increase of personnel and non-personnel-costs in order to identify, control and monitor interdependencies of clients. The same is true for the transposition of the requirements resulting from the compulsory look-through and the reporting.

**We therefore strongly request CEBS to allow for sufficient implementation deadlines as well as grandfathering provisions.**

In the following, we would like to comment in detail on your questions.

## A. Connected Clients

### 1. Are the guidelines in relation to the Interpretation of control sufficiently clear or are there issues which need to be elaborated further or which are missing?

The concept of "control" is an important criteria in practice to identify groups of connected clients. Therefore, we very much welcome a further clarification of this notion, contributing to strengthen this concept.



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The guidelines could be even clearer by only referring to the majority of voting rights and not a majority in shares. CEBS already recognizes that the mere ownership of shares does not automatically confer control and that institutions may demonstrate that what seems to be a control relationship truly is not, as e.g. there is no voting right linked to the shares (No 45). It would therefore be easier to restrict the notion of control to the majority of voting rights from the outset.

We do have concerns, however, as to the indicators of control listed in No. 39 of the draft guidelines. Given the different company laws throughout the EU, we think it is difficult to establish common indicators. Also, we do not see a prudential need to list such indicators. The criterion of control has been defined in the CRD already.

**2. Are the guidelines in relation to the Exemption from the requirement to group clients in relation to control sufficiently clear or are there issues which need to be elaborated further or which are missing?**

The EAPB very much welcomes the proposed exemption for subsidiaries of central governments, as well as regional or local authorities.

However, we take the view that it would be more sensible to **exempt all central governments or regional/local authorities** from pooling them with subsidiaries, not just those which are risk-weighted with 0 %.

The restricted exemption could also cause problems for regional or local authorities in case ratings of a country are downgraded. This could lead to an increase of the 0 % risk-weight. As a consequence the institutions would have to form enlarged groups of clients all of a sudden. In particular in the area of credit to local authorities, this would cause enormous problems and would significantly restrict lending.
At least, we would therefore plead for a grandfathering solution: credits which have been granted to the respective authorities and do not have to be grouped according to the exemption under No. 46 of the draft implementing guidelines should remain exempted until maturity of the credit.

**3. Are the guidelines in relation to the Interpretation of economic interconnectedness (single risk) sufficiently clear or are there issues which need to be elaborated further or which are missing?**

We would like to express our concern with regard to the practical implementation of the concept of one-way economic interconnectedness.



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Considering one-way dependencies between clients as set out in the CEBS draft paper would lead to a situation where large portions of a credit portfolio of an institution would constitute large exposures. Regularly, institutions will identify direct or indirect financial dependencies. As a consequence we fear that the scope of lending in particular to SMEs will be reduced. In particular the business of locally active institutions would suffer from such a practice as within a region there are obviously regularly financial dependencies between companies. But also for all other institutions, the effort and costs to identify such dependencies would be enormous.

We take the view that it is more sensible to only refer to mutual dependencies when establishing interconnectedness.

Should CEBS nevertheless include also one-way dependencies, CEBS should set up a mandatory list of criteria / facts which would trigger one-way dependency. Otherwise, there would be a large margin of discretion with regard to the applicability of this element which would cause legal uncertainty. Institutions would have to continuously liaise with the national supervisory authority on a case by case basis in order to avoid the risk of exceeding the large exposure limits due to a potentially deficient interpretation.
Such a lengthy process would also hamper tailored and prompt lending and would thwart the current efforts to avoid credit crunches.

In order to develop a (final) list of criteria it would be helpful to make an inquiry in the different Member States on the national interpretation of one-way dependency.

Furthermore, we do not see a point in including examples on retail exposures, as set out in No. 50 of the draft paper. Even in small institutions, retail exposures do not constitute large exposures. It may well be that retail exposures are linked to a large exposure. However, they would play an insignificant role in relation to the large exposure. We would therefore urge CEBS not to apply the large exposure regime to the retail sector. Given the multitude of retail exposures which would have to be assessed, such an extension of the large exposure regime would compromise the efficiency and operability of the system.

4. **Are the guidelines in relation to the Interpretation of connection through the main source of funding being common sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.**

The EAPB takes the view that the proposed interpretation of the main sources of funding would lead to major uncertainties.



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Except for the example mentioned in No. 55 of the draft paper referring to the funding / providing credit support to conduits or SPVs, the examples do not offer the necessary guidance. In No. 56 and 57 CEBS only vaguely excludes cases which would not constitute a single risk (e.g. geographic location) but does not positively enumerate cases which would – beyond SPVs – constitute a single risk due to a common main source of funding.

It would therefore be clearer and more practically to restrict the case of a single risk due to a common source of funding to the example mentioned under No. 55 regarding conduits or SPVs. We also understand that the CRD's purpose was to cover this kind of cases.

**5. What do you think about the proposed 1% threshold as proposed above?**

The EAPB very much welcomes the introduction of a threshold, as proposed by CEBS. Given the considerable costs and efforts for institutions to gather the information required in order to identify group of connected clients, we would however plead for a threshold of 5 %. Such a higher threshold would constitute an essential administrative relief. At the same time, we feel that exposures up to 5 % would be sufficiently marginal in order not to put the functioning of the large exposure regime at risk.

**6. Are the guidelines in relation to the Control and management procedures in order to identify connected clients sufficiently clear or are there issues which need to be elaborated further or which are missing?**

no comments

**7. Are there remaining areas of interpretation of the definition in Article 4(45) of Directive 2006/48/EC that need to be covered in CEBS's guidelines?**

no comments



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## B. Treatment of exposures to schemes with underlying assets

Before commenting in detail, we would like to note the following:

In order to fulfill the requirements following from the look-through principle, institutions will have to make contractual agreements with schemes in the future in order to regularly receive information on the assets contained in a scheme. Such extensive information obligations are currently not common practice. In order to allow for an adjustment to the new requirements in the contracts, for institutions as well as for schemes, it would be sensible to only apply the new rules on the look-through only to positions originated as of 31 December 2010.

Given the considerable costs and efforts for institutions to carry out a look-through on the positions listed in the CRD, it should be clarified that the repeated look-through of a product held should only be required after an adequate period of time. We consider a quarterly period as appropriate and sufficient.

### 8. Does the proposal provide sufficient flexibility for institutions to deal with different types of schemes? If you believe additional flexibility is necessary, how should the proposal be amended?

The proposed approaches do not give the institutions the flexibility required. Eventually, the guidelines would lead to a situation where institutions would have to look through to the obligor independent of the factual risk of the whole construct in order to avoid exceeding large exposure limits. The discretion for institutions which has been recently included in Art 106 (3) CRD would be undermined by the obligatory aggregation of all unknown exposures to one group of unknown connected clients.

CEBS disregards the fact that in practice, a look-through is not possible for a multitude of products. Also, in a considerable number of cases, the entities identified by looking through will not be entities to which the institution has a direct client or credit relation. Assessing the capital and the company context as a basis to establish groups of connected clients is in this cases very difficult if not possible for lack of a legal basis to obtain the required information.

Therefore we deem it necessary to introduce a de-minimis rule for sufficiently granular portfolios. In such de-minimis cases the institutions may abstain from a look-through and treat the whole construct as an independent client. The construct would then not have to be added to the group of unknown connected clients. A portfolio should be classified as granular if the respective single client would not exceed a limit of 5 % of own funds or another nominal amount. The same should be true for portfolios where the institutions do


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not know the exact composition but where the individual titles would not exceed the de-minimis limit.

Furthermore, also trading book position should be excluded from the look-through and be treated as independent clients. Given the short holding period, a look-through would not be justified.

Finally, also regulated investment funds according to the UCITS Directive should be exempted from the requirement to look through. These funds are already subject to strict limitations in order to avoid concentration risk.

**9. Do the fall-back solutions (approaches b) to d)) appropriately take into account the uncertainty arising from unknown exposures and schemes?**

The proposed four-level hierarchy for the purpose of determining the interconnectedness of the underlying assets in the schemes with other clients seems, apart from our comments under point 8, adequate. However, we deem approach d) referring to unknown exposures too conservative. It also clearly constrains the application of the other three solution proposals.

In particular with regard to multi-tranched securitisation positions it is not possible to look through to the underlying assets. As a consequence, an institution would be forced to choose approach d) and to pool the exposure to one group of unknown connected clients. In this case, the large exposure limits of institutions would be very easily exceeded. Eventually, this would further harm the securitisation market. Relieving balance sheets of institutions through securitisations are, however, important for the provision of sufficient credit to the economy. Revitalising the securitisation market should therefore not be hindered by such practices. Against this background, the institutions should be given the possibility to carry on treating non-granular securitisation positions, using elevated weightings, as independent clients. We take the view that such a treatment would be appropriate as the individual exposure of a single client is only of subordinated significance. Its default would not directly lead to the default of the invested tranche.



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10. **Do you think the partial look-through approach provides additional flexibility or would an institution in practice rather apply either a full look-through or not look through at all?**

11. **Do you think the mandate-based approach is feasible? If not, how could an approach based on the mandate work for large exposure purposes?**

The approach should be shaped in a way that the evidence of the connectedness can be proved from the mandate of the scheme. A comprehensive analysis is not necessary.

12. **Do you believe that considering all unknown exposures and schemes as belonging to one group of connected clients is too conservative (approach d)? What alternative treatment would you propose (please note that, as explained above, an approach which allows the treatment of unknown exposures and schemes as separate independent counterparties is not considered to be prudentially appropriate)?**

13. **What are your views about the proposed treatment for tranched securitisation positions?**

Also for the treatment of tranched products we are concerned that the institutions are not provided with sufficient flexibility. They are forced to either carry out a full look-through or to consider them as unknown exposures and group them with other unknown exposures.

In general, we welcome the possibility for holders of senior tranches to consider subordinated tranches as credit enhancement.

We take the view that with in the first loss position tranches with subordination should be considered as mitigating.

14. **Do you consider the proposed treatment of tranched securitisation positions when look through is applied as appropriate? Do you think that the proposed treatment sufficiently captures the risks involved in such an investment?**

Given the (potential) diversity of the structures available on the market the chosen approach is not suitable for all products. We therefore in principle support the proposal, but would welcome the inclusion of the possibility to deviate from the proposed approach in those cases where the approach is not justified for the risk level of the respective tranche.



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**15. With respect to the treatment of tranched securitisation positions: If it was be required to take every tranche into account from the outset instead of the proposed treatment, would such a treatment address all risk involved in such a transaction and would it be sufficient for addressing concerns on undue burdens?**

The general haircut requested in No. 92 for the mitigating effect of individual subordinated tranches is not justified as long as the current subordination is known or may be derived from.

**16. In which cases is there no risk from the scheme itself so that it can be excluded from the large exposure regime?**

For many funds, in particular UCITS but also securitisations, institutions investing in these funds have an entitlement for restitution of the underlying assets in case of insolvency of the scheme.

Therefore, apart from the individual assets, a look-through should only be considered for those schemes for which no solvency-proof agreement has been concluded.

## C. Reporting Requirements

We would like to urge CEBS to clarify in the document that the transposition of the reporting requirements is only possible after the COREP-reporting framework has been developed and implemented. Given the current time schedule, the development of the COREP framework will be at the earliest completed by end 2012.

**17. Do you agree that the net exposure should be calculated as proposed above?**

**18. Do you agree that the 10% limit should be calculated as proposed in column LE 1.11 above?**

**19. Regarding the example about the Credit Linked Note (set out in the text above and in Annex 5 as example 6), bank X is the protection seller and reports its potential exposure to Bank B as indirect exposure (5). Do you believe it is correct to report such exposures in column 8 or would they be better reported in column 5 as direct exposures, because they did not arise as a consequence of substitution?**

no comments



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20. **Please express your preference for one of the two alternatives outlined for the identification of a client or group of connected clients (2-Templates-Approach vs. 1-Template-Approach).**

Our members take the view that the “2-Templates-Approach” should be used.

21. **Do you agree with the proposed reporting of CRM, in particular to differentiate only between “unfunded”, “funded” and “real estate”?**
22. **Would it be possible to include more detailed information into the large exposure reporting, like total amount of collateral and guarantees available vs. the eligible part, types of securities and issuers provided as collateral or would this be too burdensome?**
23. **Please provide examples where the reporting instructions are not clear to you.**
24. **Do you think the identification system of the counterparty as proposed and based on national practices is practical? Does an identification system based on national practices generate problems for cross-border banks? If yes, please describe the problems and propose how they can be solved.**
25. **Are the references to COREP provided in this paper and in Template 1 – as set out in Annex 4 – clear and sufficient or is further guidance required? If yes, please specify the problems.**

no comments

Should you have any questions, please do not hesitate to contact us.

Kind regards,

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|---|---|
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